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SUBJECT: UNITED COMPANY RUSAL: MAKING OF A RUSSIAN NATIONAL
CHAMPION?

Classified By: Econ M/C Quanrud by reason 1.4 (b) and (d).

11. (C) SUMMARY. The proposed merger this coming spring of Russian Aluminum (RUSAL), Siberian Ural Aluminum (SUAL Group), and Glencore International AG (Glencore) into "United Company RUSAL" will create the world's largest aluminum producer, unseating Alcoa. Industry insiders cast the deal more in terms of global aluminum M&A trends than as part of the Kremlin's drive to create national champions, but both factors are at play. Neither RUSAL nor SUAL were able to launch IPOs on their own, and a clear goal of the current exercise is an IPO as soon as market conditions are ripe sometime in the next 18 months. President Putin has blessed the deal, but it still faces antimonopoly approvals in Russia and the European Union, and issues surrounding taxation, registration, and litigation could be difficult -- although RUSAL executives see these more as "technicalities" than real barriers. Igor Artemyev, Chairman of the Russian Federal Antimonopoly Service (FAS) tells us that he plans to take a vigorous look at both the impact of the merger on domestic players as well as overall trends in the global aluminum business in making his decision, but we doubt he will stand in the way of this deal. END SUMMARY.

UNITED COMPANY RUSAL

12. (U) The transaction will bring the three groups under a new holding company, United Company RUSAL, with RUSAL owning 66%, SUAL 22%, and Glencore 12%. The new company will be the world's largest aluminum and alumina producer, with an estimated worth of \$25-30 billion. It will employ more than 110,000 people in 17 countries on five continents, with annual production volumes of roughly 4 million tons of aluminum and 11 million tons of alumina -- approximately 12.5% of global aluminum production. Profits are projected to reach \$10 billion a year, much of this due to cheap electricity from hydropower in Siberia, which is said to be at the heart of the new company's business plan.

13. (C) RUSAL representatives tell us that the decision of where to register the company has not yet been made, but London seems to be where the partners are leaning. The Russian Government is likely to want to see the holding company registered in Russia, for both tax and prestige reasons. In this light, a London registration would be a significant bow to pressing commercial considerations, and is something to watch carefully. RUSAL reps say the new company has definite plans to launch an IPO -- "a key ingredient to the merger." They say the timing of the IPO will be

determined by market conditions, but for the partners, especially SUAL's Viktor Vekselberg, clearly the sooner the better.

ANTIMONOPOLY APPROVALS
AND OTHER GRITTY DETAILS

¶4. (C) The new company will need approval from at least three foreign antimonopoly agencies (the European Union, Bulgaria, and Ukraine) in addition to Russia's FAS. Tolling schemes for the export of aluminum smelted in Russia will be carefully scrutinized. Artemyev tells us he plans to analyze the effects of the merger on the world market, as well as Russian domestic companies, and will seek informal input from Alcoa (as an expert third party) in this regard. He hinted any restrictions that might be placed on the merger could be formed by guidance from Alcoa.

¶5. (C) The new company will need to contend with several litigation issues to ensure its commercial survival. One case involves Mikhail Chernoy, who claims that Oleg Deripaska (RUSAL) has shorted him by about \$3 billion on payment for a stake in Siberian Aluminum (Sibal). Press reports put total liability (taking into account other outstanding litigation against RUSAL) at approximately \$4 billion. RUSAL reps tells us this figure is inflated, and refer to litigation issues as a technicality.⁸ Simply put, no one from the firm seems very concerned that on-going or threatened litigation would affect the new company.

ALCOA AND ALCAN:
DEALS AND REACTIONS

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¶6. (C) Conversations with senior representatives of ALCOA indicate that SUAL was not Deripaska's first or only choice for this merger (which is one possible reason why it has taken more than five years for the two parties to come together). Deripaska approached ALCOA in the first half of this year, but the talks broke down when the asset valuation gap could not be closed to Deripaska's satisfaction. The announcement of the RUSAL/SUAL merger has shelved, probably indefinitely, a number of pending ALCOA plans with RUSAL in Russia, given the unlikelihood of FAS approvals going forward.

¶7. (C) According to contacts in both the aluminum industry and those close to SUAL, Vekselberg appears to have been equally reluctant to partner with RUSAL, but reconciled himself to the merger as a way to cash out of the business (through the eventual IPO) reportedly "on his own terms." Vekselberg has articulated a desire to IPO SUAL for some time now, but appears to have been unable to pull it off on his own. A back of the envelope analysis of the proposed equity division between the partners suggests Vekselberg more or less held his own in this negotiation, and that he was neither dragged into the deal, nor is facing a loss of his investment, assuming the IPO is successful.

¶8. (C) Meanwhile senior ALCAN representatives have volunteered to us their pleasure with the pending merger. The merger will force RUSAL and SUAL to play by generally accepted rules, which will have the effect of leveling the playing field. If United Company RUSAL wants to be a global leader, the firm will have to leave behind bad past practices -- which would be inconsistent with global practice, and could cost the firm its commanding edge. The merger, they say, makes a good deal of sense in light of global consolidation trends, and was likely driven in large part by pure commercial considerations.

COMMENT

19. (C) The prospective merger was announced by Deripaska immediately following a meeting with Putin (at which Vekselberg was also present) which RUSAL contacts say signals the deal has Putin's blessing. Deripaska enjoys a favorable relationship with President Putin -- he is a more or less permanent fixture on Putin's trips abroad, and he is widely acknowledged by our contacts to be among the 2-3 oligarchs Putin turns to on a regular basis. Viktor Vekselberg has arguably been at the sharp end of the stick more than once over the past year, between being bought out of his VMSP0 titanium shares, and being caught in an uncomfortable squeeze play with his TNK partners. The merger is both good business and potentially good politics for both of them, but there is a fine line emerging here. The degree to which the partners are allowed to pursue their commercial instincts (registering the firm in London, with a probable IPO on the London Stock Exchange) will tell us how important the drive for national champions is to the Kremlin. Our RUSAL contacts were visibly nervous on this point, and we understand why. END COMMENT
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